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Cost are not then due and payable, then we and the Obligor by written agreement shall extend the Termination Date for such period as we and the Obligor shall determine is sufficient to allow for such contingencies. Any amounts remaining in the Escrow Fund on the Termination Date which are in excess of 87½ percent or 75 percent of Actual Cost, as the case may be, shall be applied to retire a pro rata portion of the Obligations.

§ 298.34 Construction fund.

(a) *Circumstances requiring deposits.* (1) When the Security Agreement provides for the establishment of an Escrow Fund, the Obligor shall also make Construction Fund deposits when the Obligor:

(i) Submits a claim to the agency that it has previously paid for items of Actual Cost and

(ii) Is seeking reimbursement at the Closing.

(2) The Obligor shall make the Construction Fund deposits as follows:

(i) At the time of the sale of the Obligations, the Obligor shall deposit with the Depository cash equal to the principal amount of the Obligations issued at such time less the sum of the aggregate principal amount then required to be in the Escrow Fund, and

(ii) The amount in excess of 12½ or 25 percent of Actual Cost or Depreciated Actual Cost, as applicable (whichever is payable under § 298.33(b) which we determine has been paid by or for the account of the Obligor.

(b) *Security interest and control.* We must have a security interest in and control over the Construction Fund and its proceeds.

(c) *Balance of the proceeds.* The Obligor will retain the balance of the proceeds, if any, from the sale of the Obligations, after depositing the amounts required to be deposited in the Escrow Fund and/or the Construction Fund.

(d) *Withdrawals and redeposits.* We shall, subject to the satisfaction of any applicable conditions contained in the Security Agreement, periodically approve disbursements from the Construction Fund under the same procedures and conditions as from the Escrow Fund in § 298.33(b), except the request for withdrawal will not be sub-

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ject to § 298.33(b)(2)(i) and (e). The administration of the Construction Fund shall also be subject to the terms and conditions of § 298.33.

§ 298.35 Title XI Reserve Fund and Financial Agreement.

(a) *Purpose.* In order to provide us with further security and to ensure payment of the interest and principal due on the Obligations, we will require the Company to enter into a Title XI Reserve Fund and Financial Agreement (Agreement) at the first Closing at which the Company issues Obligations. We may waive or modify provisions of the Agreement based on our evaluation of the aggregate security for the Guarantees.

(b) *Financial covenants.* There will be two sets of covenants. One set of covenants will be imposed regardless of the Company's financial condition (primary covenants). The other set of covenants will be imposed only if the Company does not meet specific financial conditions (supplemental covenants). The primary and supplemental covenants are to be set forth in the Agreement. Covenants shall be imposed on the Company as follows:

(1) *Primary covenants.* So long as Guarantees are in effect the Company shall not, without our prior written consent:

(i) Make any distribution of earnings, except as may be permitted as follows:

(A) From retained earnings in an amount specified in paragraph (b)(1)(i)(C) of this section, provided that, in the fiscal year in which the distribution of earnings is made there is no operating loss to the date of such payment of such distribution of earnings, and there was no operating loss in the immediately preceding three fiscal years, or there was a one-year operating loss during the immediately preceding three fiscal years, but such loss was not in the immediately preceding fiscal year, and there was positive net income for the three year period;

(B) If distributions of earnings may not be made under paragraph (b)(1)(i)(A) of this section, a distribution can be made in an amount equal to the total operating net income for the immediately preceding three fiscal year period, provided that:

(1) There were no two successive years of operating losses;

(2) There is no operating loss to the date of such distribution in the fiscal year in which such distribution is made; and

(3) The distribution of earnings made would not exceed an amount specified in paragraph (b)(1)(i)(C) of this section;

(C) Distributions of earnings may be made from earnings of prior years in an aggregate amount equal to 40 percent of the Company's total net income after tax for each of the prior years, less any distributions that were made in such years; or the aggregate of the Company's total net income after tax for such prior years, provided that, after making such distribution, the Company's Long-Term Debt does not exceed its Net Worth. In computing net income for purposes of this paragraph (b)(1)(i)(C), extraordinary gains, such as gains from the sale of assets, will be excluded;

(ii) Enter into any service, management or operating agreement for the operation of the Vessel or the Shipyard Project (excluding husbanding type agreements), or appoint or designate a managing or operating agent for the operation of the Vessel or the Shipyard Project (excluding husbanding agents) unless approved by us;

(iii) Sell, mortgage, transfer, or demise charter the Vessel or the Shipyard Project or any assets to any non-Related Party except as permitted in paragraph (b)(1)(vii) of this section or sell, mortgage, transfer, or demise charter the Vessel or any assets to a Related Party, unless such transaction is at a fair market value as determined by an independent appraiser acceptable to us, and is a total cash transaction;

(iv) Enter into any agreement for both sale and leaseback of the same assets so sold unless the proceeds from such sale are at least equal to the fair market value of the property sold;

(v) Guarantee, or otherwise become liable for the obligations of any other Person, except with respect to any undertakings as to the fees and expenses of the Indenture Trustee, except endorsement for deposit of checks and other negotiable instruments acquired in the ordinary course of business and

except as otherwise permitted in this section;

(vi) Directly or indirectly embark on any new enterprise or business activity not directly connected with the business of shipping or other activity in which the Company is actively engaged;

(vii) Enter into any merger or consolidation or convey, sell, demise charter, or otherwise transfer, or dispose of any portion of its properties or assets (any and all of which acts are encompassed within the words "sale" or "sold" as used in this section), provided that, the Company will not be deemed to have sold such properties or assets if the net book value of the aggregate of all the assets sold by the Company during any period of 12 consecutive calendar months does not exceed ten percent of the total net book value of all of the Company's assets; the Company retains the proceeds of the sale of assets for use in accordance with the Company's regular business activities; and the sale is not otherwise prohibited by paragraph (b)(1)(iii) of this section. The Company may not consummate such sale without our prior written consent if the Company has not, prior to the time of such sale, submitted to us, as required, its most recently audited financial statements referred to in §298.42(a) and any attempt to consummate a sale absent such approval will be null and void *ab initio*.

(2) *Supplemental Covenants which may become applicable.* Unless, after giving effect to such transaction or transactions, during any fiscal year of the Company, the Company's Working Capital is equal to at least one dollar, the Company's Long-Term Debt does not exceed two times the Company's Net Worth and the Company's Net Worth is at least the amount specified by us, the Company shall not, without our prior written consent:

(i) Withdraw any capital;

(ii) Redeem any share capital or convert any of the same into debt;

(iii) Pay any dividend (except dividends payable in capital stock of the Company);

(iv) Make any loan or advance (except advances to cover current expenses of the Company), either directly

or indirectly, to any stockholder, director, officer, or employee of the Company, or to any other Related Party;

(v) Make any investments in the securities of any Related Party;

(vi) Prepay in whole or in part any indebtedness to any stockholder, director, officer, or employee of the Company, or to any Related Party, which has a stated maturity of more than one year from such date;

(vii) Increase any direct employee compensation (as defined in this paragraph) paid to any employee in excess of \$100,000 per annum; nor increase any direct employee compensation which is already in excess of \$100,000 per annum; nor initially employ or re-employ any person at a direct employee compensation rate in excess of \$100,000 per annum; provided, however, that beginning with January 1, 2000 the \$100,000 limit may be increased annually based on the previous years' closing Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics. For the purpose of this paragraph, the term "direct employee compensation" is the total amount of any wage, salary, bonus commission, or other form of direct payment to any employee from all companies with guarantees under the Act as reported to the Internal Revenue Service for any fiscal year.

(viii) Acquire any fixed assets other than those required for the maintenance of the Company's existing assets, including normal maintenance and operation of any vessel or vessels owned or chartered by the Company;

(ix) Either enter into or become liable (directly or indirectly) under charters and leases (having a term of six months or more) for the payment of charter hire and rent on all such charters and leases which have annual payments aggregating in excess of an amount specified by us;

(x) Pay any indebtedness subordinated to the Obligations or to any other Title XI obligations;

(xi) Create, assume, incur, or in any manner become liable for any indebtedness, except current liabilities, or short term loans, incurred or assumed in the ordinary course of business as such business presently exists;

(xii) Make any investment whether by acquisition of stock or indebtedness, or by loan, advance, transfer of property, capital contribution, guarantee of indebtedness or otherwise, in any Person, other than obligations of the United States, bank deposits or investments in securities of the character permitted for monies in the Title XI Reserve Fund; and,

(xiii) Create, assume, permit or suffer to exist or continue any mortgage, lien, charge or encumbrance upon, or pledge of, or subject to the prior payment of any indebtedness, any of its property or assets, real or personal, tangible or intangible, whether now owned or thereafter acquired, or own or acquire, or agree to acquire, title to any property of any kind subject to or upon a chattel mortgage or conditional sales agreement or other title retention agreement, except loans, mortgages and indebtedness guaranteed by us under Title XI of the Act or related to the construction of a vessel approved for Title XI by us, and liens incurred in the ordinary course of business as such business presently exists.

(c) *Title XI Reserve Fund Net Income.* The Agreement shall provide that within 105 days after the end of its accounting year, the Company will compute its net income attributable to the operation of the Vessel(s) that were constructed, reconstructed, reconditioned or refinanced with Title XI financing assistance (Title XI Reserve Fund Net Income). The computation utilizes a ratio expressed as a percentage, and applies this percentage to the Company's total net income after taxes. The numerator of the ratio is the total original capitalized cost of all Company Vessels (whether leased or owned) which were constructed, reconstructed, reconditioned or refinanced with the assistance of Guarantees. The denominator shall be the total original capitalized cost of all the Company's fixed assets. In the case of Shipyard Project, the Agreement shall provide that within 105 days after the end of its accounting year, the Company shall submit its audited financial statements showing its net cash flow in a manner acceptable to us, in lieu of any other

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computation of Reserve Fund Net Income specified in this section for Vessels. The net income after taxes, computed in accordance with GAAP, will be adjusted as follows:

(1) The depreciation expense applicable to the accounting year shall be added back.

(2) There shall be subtracted:

(i) An amount equal to the principal amount of debt required to be paid or redeemed, and actually paid or redeemed by the Company (other than from the Title XI Reserve Fund) during the year; and

(ii) The principal amount of Obligations retired or paid (as defined in the Security Agreement), prepaid or redeemed, in excess of the required redemptions or payments which may be used by the Company as a credit against future required redemptions or other required payments with respect to the Obligations.

(d) *Deposits.* Unless the Company, as of the close of its accounting year, was subject to and in compliance with the financial requirements set forth in paragraph (b)(2) of this section, the Company shall make one or more deposits to a special joint depository account with us (the Title XI Reserve Fund) to be established pursuant to an agreement in writing (Depository Agreement) at the time the first deposit is required to be made. The amount of deposit as to any year, or period less than a full year, where applicable, will be determined as follows:

(1) Fifty percent of the Title XI Reserve Fund Net Income, less an amount equal to 10% of the Company's total original equity investment in the Vessel or Vessels, (if the Company is the owner of the assets), will be deposited into the Title XI Reserve Fund.

(2) In the case of Shipyard Project, the shipyard shall make a deposit at two percent of its net cash flow, as defined by GAAP, and as shown on its audited financial statements.

(3) Any additional amounts that may be required pursuant to the Security Agreement or any other agreement in the documentation to which the Company is a party.

(4) Any additional amounts that may be required, pursuant to provisions of the Security Agreement or any other

agreement in the documentation to which the Company is a party.

(5) Irrespective of the Company's deposit requirement, as stated in paragraphs (d) (1) through (4) of this section, the Company will not be required to make any deposits into the Title XI Reserve Fund if any of the following events will have occurred:

(i) The Company will have discharged the Obligations and related Secretary's Note and will have paid other sums secured under the Security Agreement and Preferred Mortgage;

(ii) All Guarantees with respect to outstanding Obligations will have terminated pursuant to the provisions of the Security Agreements, other than by reason of payment of the Guarantees; or

(iii) The amount in the Title XI Reserve Fund, (including any securities at market value), is equal to, or in excess of 50 percent of the principal amount of outstanding Obligations.

(e) *Fund in lieu of Title XI Reserve Fund.* If the Company has established a Capital Construction Fund (CCF), pursuant to section 607 of the Act, whether interim or permanent, at any time when a deposit would otherwise be required to be made into the Title XI Reserve Fund, and the Company elects to make such deposits to the CCF, the Company must enter into an agreement, satisfactory to us, providing that all such deposits of assets therein will be security (CCF Security Amount) to the United States in lieu of the Title XI Reserve Fund. The deposit requirements of the Title XI Reserve Fund and Financial Agreement will be deemed satisfied by deposits of equal amounts in the CCF, and withdrawal of the CCF Security Amount will be subject to our prior written consent. If, for any reason, the CCF terminates prior to the payment of the Obligations, the Secretary's Note and all other amounts due under or secured by the Security Agreement or Mortgage, the CCF Security Amount will be deposited or redeposited in the Title XI Reserve Fund.

§ 298.36 Guarantee Fee.

(a) *Rates in general.* (1) For annual periods, beginning with the date of the Security Agreement and prior to the delivery date of a Vessel or Shipyard